



CITY OF MORGAN HILL

17555 PEAK AVENUE MORGAN HILL CALIFORNIA 95037

July 1, 2001

HONORABLE MAYOR AND CITY COUNCIL

SUBJECT: FISCAL YEAR 2001/02 BUDGET

Dear Mayor Kennedy and Members of the City Council:

It is a privilege to submit the Fiscal Year 2001/02 Budget. The budget is a plan to meet community needs through effective use of the City's available resources. It reflects the City Council's commitment to fiscal responsibility through long term prudent financial planning. The goals of this strategy are to maintain a prudent level of reserves, to cost effectively provide municipal services, and to pre-fund known expenditure expectations.

The current budget document and Capital Improvement Program (CIP) provide a pro-active, forward-looking program to address the dynamic needs of our City. We have the opportunity, based on revenues derived from an exceptionally healthy regional economy over the last several years, to move forward on a number of fronts and to effectively plan and implement public programs and services.

ECONOMIC AND DEMOGRAPHIC PROFILE

The City of Morgan Hill provides a high quality residential community for our many citizens who commute north to their jobs. Population increased by 3.08% as of January 1, 2001 compared to the prior year, to a level of 34,596, according to the State Department of Finance. The economic success of Silicon Valley impacts our residents through relatively high family income. The top 20 employers currently employ approximately 6,000 persons in Morgan Hill. Accompanying pressure on available housing stock results from both citizens who choose to live here and commute to other locales, and also from employees to whom Morgan Hill is home. As a result, housing costs increased by 22% in calendar year 2000, compared to 1999, to a median single family home price

of \$519,000. However, the median price for a single family residence dropped to \$495,000 in March 2001 as the number of sales dropped by approximately 50% and as the economy shifted to a slower rate of growth. Employee layoffs in the greater Silicon Valley are contributing to a slowdown in the economy. In addition, the significant uncertainty in the cost of electricity for the next year has prompted us to budget 50% more for electricity for 2001/02. This additional budget of approximately \$658,000 relates primarily to the sewer and water operations. A special analysis on this subject is included in the Special Analysis section of the budget.

The City provides a broad range of services, including police protection, development and housing, water and sanitation services, streets and parks construction and maintenance, planning, engineering, code enforcement, recreation, general city administration, and support services. The City has contracted with Santa Clara County to provide fire protection services and with South Valley Disposal and Recycling to provide solid waste collection services.

As the local economy slows, the City's policy of establishing prudent reserves makes good financial sense. The State of California is currently struggling to combat the energy crisis that has drained State coffers, so it is unlikely that the City will receive significant new financial assistance from the State in the near future. However, the City has been very successful in maximizing grant funds for street projects. Sales tax revenue continues to grow, increasing by approximately 14% in 2000/01, as projected, to a level of approximately \$5.1 million. Reduced growth of approximately 4%, to a new level of \$5.3 million, is projected for 2001/02.

BUDGET PROCESS

The Fiscal Year 2001/2002 Budget is based upon an in-depth analysis of actual and projected fund balances, revenues, and expenditures. Each City department prepared line item detail for each of their activities and recommended certain service levels and activity goals for the 2001/02 Budget year. The Finance Department prepared revenue projections based upon input from other departments. The City Manager then reviewed individual departmental requests, prioritized activities based upon City Council policy, and made certain adjustments. At the conclusion of this process, the proposed budget was prepared and is being submitted to the City Council for review.

BUDGET OVERVIEW

BUDGET HEADLINES

- ✓ Assist the Morgan Hill Community Health Foundation to provide medical services
- ✓ Develop plan and obtain funding for new Library
- ✓ Continue to work with the County to co-locate courthouse and police facility
- ✓ Expedite widening of Highway 101
- ✓ Establish strategic financial plan, including preparation of five year financial forecast
- ✓ Analyze future needs for City facilities and present plan for meeting them

- ✓ Implement e-government strategic plan
- ✓ Identify & implement strategies for expanded deployment of bicycle and foot patrols
- ✓ Concentrate police investigative time toward juvenile, gang, and auto burglary
- ✓ Conduct assessment of critical traffic enforcement issues & develop solutions
- ✓ Implement Fire Suppression & Emergency Medical Services Master Plan
- ✓ Increase level of animal control services
- ✓ Initiate sidewalk and curb/gutter repair program
- ✓ Complete & update Design Review Ordinance & Architectural Review Handbook
- ✓ Develop a Gateway Plan & Design Guidelines for community entry points
- ✓ Complete Transit Village Plan & Update of the Downtown Plan
- ✓ Update the Housing Element & prepare Implementation Plan for General Plan
- ✓ Undertake Greenbelt Study and Land Use Plan
- ✓ Expand curbside recycling to include plastics 3 - 7
- ✓ Complete master plans/business plans for Community Recreation Center & Aquatics Complex, and update plan for Community & Cultural Center
- ✓ Expand Recreation programs, including youth scholarships and programs for disabled
- ✓ Establish "Friends of Morgan Hill Parks & Recreation" foundation for fund raising
- ✓ Implement technology that allows building permit submittals over Internet
- ✓ Provide engineering staff space in City Hall to improve customer service
- ✓ Identify & purchase a site for new Police Facility & develop new facility master plan
- ✓ Complete relocation and renovation of Community Playhouse
- ✓ Finalize design of "Church Street Trailer Park" project
- ✓ Construct Murphy Ranch housing & Nob Hill Terrace neighborhood improvements
- ✓ Install system upgrades at various Sewer Lift Stations
- ✓ Implement Sewer Infiltration & Inflow Reduction Plan
- ✓ Complete design of 2 - 4 million gallon water reservoir near Edmundson Avenue
- ✓ Construct 1 million gallon reservoir at Boys Ranch site
- ✓ Replace older water lines in various areas of city & drill new water well
- ✓ Improve City's budget process by incorporating departmental performance measures
- ✓ Prepare plan for implementing GASB 34 financial and infrastructure reporting
- ✓ Start preliminary design/property acquisition for Library, Indoor Recreation Center, Aquatics Center, & Sports Complex
- ✓ Complete SR101/Dunne interchange landscaping

- ✓ Commence construction of new Community Center
- ✓ Commence construction of Butterfield Blvd. Extension from San Pedro to Tennant
- ✓ Complete major street rehabilitation project
- ✓ Begin improvements to increase capacity of Wastewater Treatment Plant to 8.5 MGD
- ✓ Aggressively deliver 5 year Capital Improvement Plan (CIP) of \$142 million

HIGHLIGHTS - FISCAL ISSUES

The total budget for Fiscal Year 2001/02 (including capital project appropriations and Redevelopment Agency appropriations, but excluding transfers out) is \$98,812,819, or \$11,527,832 more than the 2000/01 budget. The budget includes a CIP of \$44,572,000 for 2001/02. The budget also includes the addition of approximately 14 full-time equivalent positions, as follows:

Recreation:

2 & ½ positions are proposed (Community Services Analyst, Leisure Services Coordinator, & part-time Office Assistant) to expand the Recreation programs, and provide better service to the public and citizen committees.

City Clerk:

A Municipal Services Assistant position is proposed to assist this department in supporting the administrative needs of the Mayor and City Council.

Public Works:

5 positions are proposed (Project Manager, Inspection Manager, Utility Worker I, Utility Worker II, & Senior Maintenance Worker) to meet the increased demand for Public Works services associated with a growing community.

Police:

A Management Analyst is proposed to provide analytic services to the Department and free up Safety personnel to provide more efficient police services.

Finance:

A part-time student intern is proposed to assist the Department in meeting clerical needs associated with a growing workload.

Community Development:

2 positions are proposed (Senior Planner & a half-time Management Analyst) to provide more professional staffing to meet the demands of a demanding workload.

Human Resources:

A half-time Human Resources Assistant is proposed to assist the Department in handling its very active recruitment workload.

Business Assistance & Housing:

Two positions (Project Manager & half-time Office Assistant) are proposed to support the Department's needs in dealing with the large amount of property acquisition work facing the Department.

In addition, certain changes have been incorporated into the Budget as a result of consultant studies in the areas of workers' compensation and liability actuarial studies, General Administration cost allocation, and internal service funds cost allocation, and as the result of independent auditor recommendations concerning simplification of fund structure and interfund transfers. These changes are necessary because it has been a number of years since the City reviewed the cost allocation and accounting structure methodology in great detail, and it was time to review our processes to ensure that the City accurately provides financial information in an understandable and meaningful manner and accurately allocates costs.

HIGHLIGHTS - CHANGES IN BUDGET FORMAT

Specific changes have been made to the budget document as follows:

- Staff recommends the elimination of separate internal service funds for the Finance, Human Resources, and City Attorney functions to simplify the accounting for these activities. This Budget presents these activities as part of the General Fund. Internal service funds were first set up for these activities in 1992/93 following the City's budget difficulties to separately account for these activities. By reflecting these costs in separate internal service funds, the 1992/93 Budget presentation focused the public's attention on vital services such as Police and Fire, and showed Finance, Human Resources, and City Attorney services as charges to the Departmental budgets rather than as General Fund departments. The elimination of these funds means that there would no longer be internal service fund charges for these activities to all funds. Instead, the costs would be shown within the General Fund and would be partially offset by new General Administration cost allocation charges to all funds, other than the General Fund, benefiting from these services. The net effect of these changes on the General Fund would be \$0, as discussed in a special analysis in the "Supplemental Information" section of the Budget.
- Elimination of the Government Public Access Fund by rolling this activity into the General Fund to consolidate all related activity in one fund.
- Incorporation of the CIP into the Budget as an appendix for easy reference.
- Incorporation of AB1290 Annual Review within the "Special Analysis" section of the Budget for easy reference.
- Elimination of the Sewer System Replacement and Water System Replacement Funds by combining each with the corresponding Sewer Capital Projects and Water System Capital Projects Funds to simplify the accounting and reduce the number of capital funds.

- Elimination of many budgetary transfers reflected in previous budgets and a new emphasis on charging costs directly to the applicable funds. This emphasis reduces the size of the Budget by showing certain costs only once rather than reflecting costs once as a transfer out to another fund and again as expenditure.
- Addition of "Pilot Programs" in the Supplemental Information section of the budget. These analyses are provided on the subjects of the Police Officer Housing Assistance Program, the Millennium Housing Paint Program, and Recreation Pilot Programs.

FUND SUMMARIES

GENERAL FUND

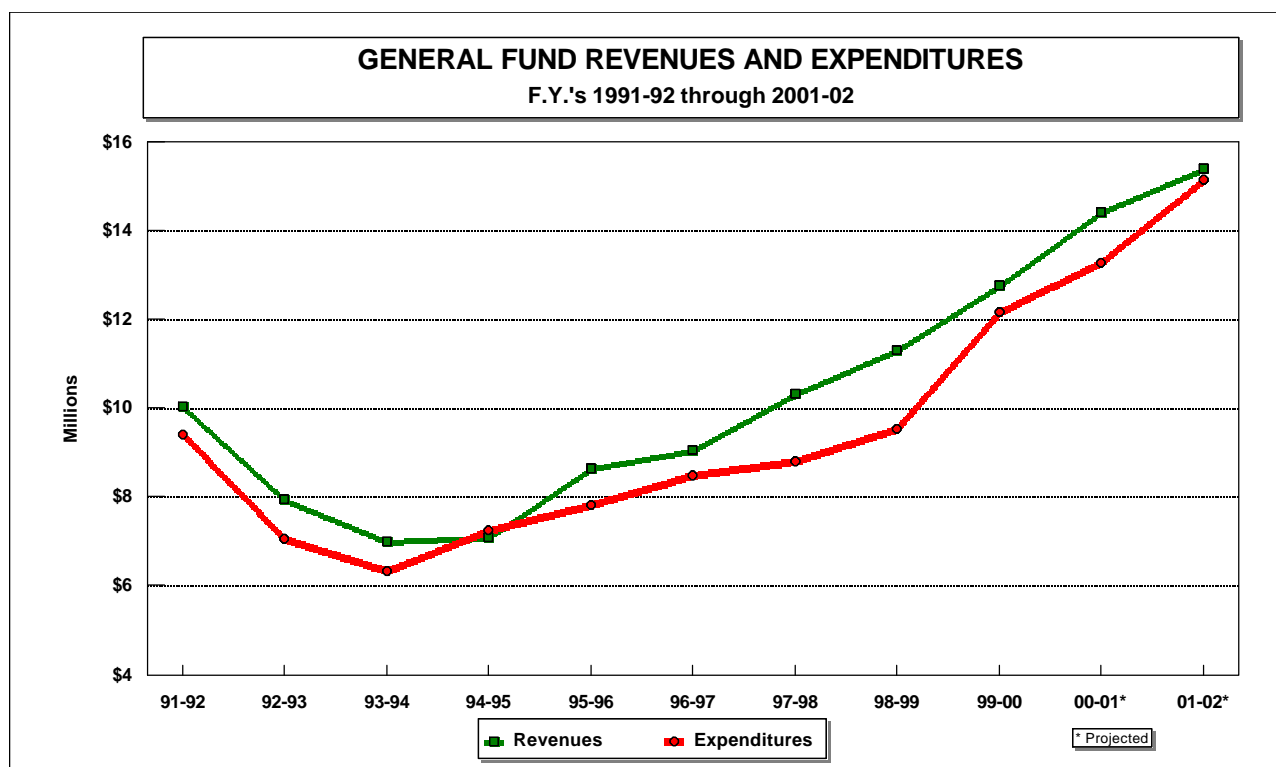
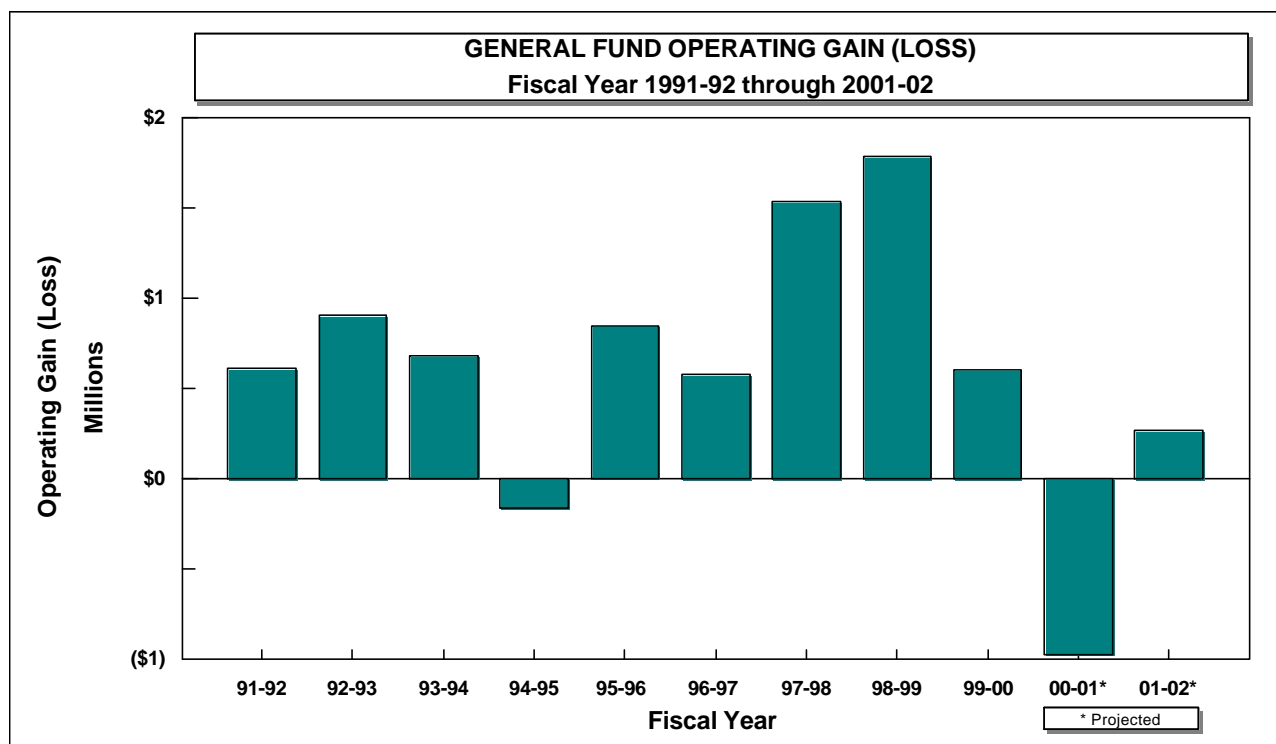
One year ago, the City Council adopted a budget that predicted an available fund balance at 6/30/2001 of \$5,544,835 for the General Fund, after designating \$3 million of the General Fund balance for specific purposes. The good news is that the available balance at 6/30/2001 is now projected to be \$6,617,173, or \$1.1 million more than previously projected. This positive result stems from a strong economy and from spending controls applied by City departments. The budget for 2001/02 provides an additional \$67,797 increase in available fund balance to \$6,684,970.

Revenues for the General Fund, including transfers in, are estimated to be \$15,404,366. This represents a 23% increase over the previous year's budget, which is primarily related to the inclusion of the Finance, Human Resources, and City Attorney activity in the General Fund in 2001/02, but not in the prior year. By excluding the revenue related to these functions, revenues would instead increase by 12%. Rapid growth of 15% in projected 2000/01 sales taxes and growth of 34% in projected 2000/01 transit occupancy taxes exceeded the 2000/01 budget and account for most of the budgeted revenue growth estimated for 2001/02. In general, the 2001/02 Budget estimates reflect continued growth for most General Fund revenues, but at a lower rate of growth. Most revenues, including sales taxes and property taxes, are projected to increase by 4 to 5% in 2001/02.

Appropriations for 2001/02, including transfers out, are \$15,136,569, which represents a 10% increase compared to the prior year budget. However, if the Finance, Human Resources, and City Attorney activity in the General Fund are excluded from 2001/02, and if one-time project related transfers out of the General Fund for 2001/02 are excluded from the prior year, expenditures for the General Fund would still increase by 9% over the prior year.

The General Fund budget includes an additional \$250,000 in 2001/02 to assist the Morgan Hill Community Health Foundation in providing medical services to the community.

The two graphs below show that there has been a consistent General Fund operating surplus since 1991/92 that has provided growth in fund balance. These surpluses have increased fund balance from \$504,095 at 6/30/92 to \$9,884,970, including designations, at 6/30/2002, as projected.



In order to strategically plan for the future, it is appropriate for the City to explain the purpose of this reserve. Based upon this premise, a total of \$3 million was designated in the 2000/01 Budget. Staff recommends that designations be increased to a new level of \$3.2 million by the City Council for the following critical purposes:

- Designation for economic uncertainty: \$1 million
- Designation for emergencies: \$1 million
- Designation for Fire Master Plan Implementation: \$1.2 million

By designating the \$3.2 million, the available undesignated fund balance for the General Fund would be \$6,684,970, or 44% of the \$15,136,569 budget, which is close to the 50% reserve goal previously set by the City Council, and which is certainly a very safe reserve level. While not designated for specific purposes, the remaining \$6,684,970 is available for important purposes such as meeting cash flow needs, contingent liabilities for operational & facilities needs, future projects, and other designations to meet community needs.

However, the General Fund is not the only fund with discretionary reserves. Equally important, the budget proposes to increase the funding of reserves to meet contingent liabilities for workers' compensation, insurance, building repairs & replacements, vehicle & equipment replacements, and future operations & maintenance of parks and public facilities. The City has pre-funded future operational needs by establishing and building reserves in funds other than the General Fund. Total discretionary reserves for all funds, including the General fund, Community Center Fund, Park Maintenance Fund, and seven internal services funds, are projected to total \$17,075,847 at June 30, 2002, as detailed in a Special Analysis on City Discretionary Reserves in the "Supplemental Information" section of the budget.

Most of the General Fund is committed to Public Safety. Police appropriations are \$6,287,232 and Fire appropriations are \$3,527,741. The total of these amounts accounts for 65% of General Fund appropriations.

The remainder of the General Fund accounts for General Government operations (City Council, City Clerk, City Manager, Finance, Human Resources, and City Attorney) and Park Maintenance and Recreation Services. A significant portion of the administrative cost is recovered in the form of charges to other City Departments for services performed. Maintenance for the proposed Community Center will come from the General Fund creating another opportunity and commitment. It is anticipated that this new, ongoing financial commitment, high on the City Council's priorities, can be absorbed by the General Fund in the years to come.

Recommended transfers out of the General Fund for 2001/02 include a \$200,000 annual contribution to the Community Center Operations Fund to meet this commitment. In addition, staff has included in the Budget projections for 2000/01 a \$200,000 transfer from the General Fund to the Park Maintenance Fund for future park maintenance purposes and a \$195,000 one-time transfer to the Street Maintenance Fund for the East Dunne Avenue Median Improvements.

The most significant sources of General Fund revenues are:

- Sales Tax of \$5,300,000, or 34% of total estimated revenues
- Property taxes of \$1,726,000, or 11% of total estimated revenues
- Motor Vehicle State Subventions of \$1,750,000 or 11% of total estimated revenues
- Transient Occupancy Tax of \$1,533,000, or 10% of total estimated revenues
- Franchise Fees of \$948,602, or 6% of total estimated revenues

The following chart shows how much of the 2001/02 General Fund budget is supported by discretionary general taxes and other revenues paid by residents and businesses. As shown below, all General Fund costs not recovered through departmental revenues (fees, grants, and reimbursements) are fully financed by discretionary revenues.

DEPARTMENT	TOTAL COSTS	LESS DEPT REVENUES	LESS TRANSFERS IN	NET COSTS
City Council	\$ 304,562	\$ 174,994		\$ 129,568
Community Promotions	24,534			24,534
City Attorney	554,316	315,228		239,088
City Manager	407,125	145,095		262,030
Recreation	599,860	8,000		591,860
Human Resources	566,439	184,880		381,559
Volunteer Program	61,481	24,826		36,655
City Clerk	327,298	325,336		1,962
Elections	52,221			52,221
Finance	877,520	554,183		323,337
Finance - Non-Departmental	250,000			250,000
Police - Admin	460,033			460,033
Police - Patrol	2,858,187		495,848	2,362,339
Police - Support Services	1,222,778	231,252		991,526
Police - Emergency Services	51,222			51,222
Police - Special Operations	1,022,105			1,022,105
Fire Administration	3,527,741	4,700		3,523,041
Government Public Access	69,605	32,000		37,605
Park Maintenance	756,635		100,000	656,635
Animal Control	110,945	45,000		65,945
Dispatch Services	561,962			561,962
Other Transfers Out	470,000		30,000	440,000
TOTALS	\$15,136,569	\$2,045,494	\$625,848	\$12,465,227
FINANCED BY DISCRETIONARY REVENUES				\$12,465,227

COMMUNITY DEVELOPMENT FUND

The Community Development Fund is a special revenue fund used to account for services supporting private development activity. The fund is dependent upon the collection of planning, building and engineering development fees to finance the Department's costs. This year appropriations are \$3,549,732, which represents a 17% increase over the prior year's budget. Revenues in 2001/02 are estimated to be \$1,934,240, or 17% less than the prior year budgeted revenues. Sufficient fund balance exists to fund these costs not financed through expected revenue. A consultant is currently reviewing the adequacy of the City's various community development fees, and staff will bring proposals to the City Council for fee revisions, as warranted, by the fall of 2001, which may increase revenues in this fund.

The General Plan Update Fund continues to provide the resources for the General Plan Update. The 2001/02 program provides initial funding for the Greenbelt Study. The General Plan Update effort is critical for the City as it provides the basic policy blueprint on growth, development and services.

STREET MAINTENANCE FUND

The Street Maintenance Fund is a special revenue fund used exclusively for street maintenance and traffic safety activities. Included are maintenance and repair of all roadways, streets, curbs, gutters, medians, roadway shoulders, and alleys; cleaning and repair of catch basins and storm drains; traffic engineering, safety studies and modifications, and related geographic information systems; street lighting and signal operations; and painting, marking, and striping. State gas tax funds are distributed based on population.

Revenues, excluding transfers in, are budgeted to be \$1,775,819, including \$632,619 of Gas Tax funds, \$522,000 of TEA-21 funds, \$100,000 of AB 2928 monies, \$360,000 of Safe Routes to School Grant funds, and \$46,000 in STIP funding. Budgeted revenues represent a 10% increase over last year, related to one-time grant funds. In addition, the Street Fund will receive \$780,000 of transfers in. Appropriations and transfers out total \$4,041,421 and are divided between street maintenance costs of \$1,825,421 and capital projects costs of \$2,216,000, including \$435,000 for the Live Oak Bicycle/Pedestrian Trail, \$980,000 for the Pavement Rehabilitation Program, \$320,000 for the Monterey/UPRR Pedestrian Access & Bike Path, \$286,000 for the Main Avenue At-grade UPRR Safety Improvements, and the \$195,000 for the East Dunne Avenue Median Improvements.

PARK MAINTENANCE FUND

The City Council established this fund as an "endowment" fund for park maintenance. The interest received on the principal balance of the fund is to be appropriated strictly for maintenance of the City's parks. Revenues come from double park fees and from previous one-time general fund transfers of "excess" General Fund reserves.

The creation of this fund provided the basis for short and long-term maintenance of many of the existing and proposed park facilities in Morgan Hill. The interest revenue from this park maintenance "endowment" fund generates at least \$100,000 per year in additional park

maintenance funds that is used to pay for personnel in the Park Maintenance operation. This fund over time may resolve park maintenance concerns of City policy makers and residents. The 2000/01 Budget projections included in this document include a one-time \$200,000 transfer from the General Fund to the Park Maintenance Fund to assist in meeting future Park Maintenance needs.

SEWER AND WATER FUNDS

These are enterprise funds, where all costs incurred are covered by the fees and charges paid by users of the systems. Presently, the City has approximately 12,000 accounts (including residential and business customers). The City water system meets or exceeds water quality standards. Budget details on these funds are found under the Public Works section of the budget document listed as Water Operations and Sewer Operations.

The Sewer Operations Fund budget of \$6,668,704 reflects a \$970,204 excess of expenditures over revenue for 2001/02, and the Water Operations Fund budget of \$7,100,741 reflects a \$423,498 excess of expenditures over revenue. Sufficient fund balance exists within each of these funds to fully finance these costs. A study of the sewer and water rates by a consultant is underway and the results will be available by the fall of 2001. The rate study will provide the information we need to make corrections for the long-term, considering the resources on hand and future capital needs.

INTERNAL SERVICE FUNDS

Internal Service funds are essentially responsibility centers within the City that provide services to other departments. These other departments are then charged for the portion of services provided to them by the respective internal service responsibility center. These funds include Equipment Replacement, Information Systems, Building Maintenance, CIP Administration, and various Insurances. As a result of staff analysis, in conjunction with a consultant, specific charges have been allocated through the Internal Service fund structure to the various departments throughout the City using a revised methodology that considers current conditions and benefits. Beginning with 2001/02, the Finance, Human Resources, and City Attorney internal service funds have been eliminated and those activities are reflected within the General Fund. The remaining fund balances for the Human Resources and City Attorney Funds will be transferred to the General Fund at June 30, 2001, while the remaining fund balance for the Finance Fund will be transferred to the Information Systems Fund at the same time to be used for future City financial systems and other City-wide information system needs.

CAPITAL PROJECTS FUNDS

Total capital projects are budgeted at \$44,572,000, as reflected in the CIP attached as an appendix. The capital projects budget is comprised of:

- Parks and Recreation projects totaling \$2,402,000
- Public Facilities projects totaling \$20,341,000
- Sanitary Sewer projects totaling \$3,618,000
- Streets projects totaling \$8,791,000

- Storm Drainage projects totaling \$2,305,000
- Water projects totaling \$7,475,000

Capital projects are described in detail within the CIP. Current year projects are included in the budget document under the applicable responsibility centers. Projects for 2001/02 include:

- Community/Cultural Center (\$12.9 million for construction)
- Community Playhouse (\$1.2 million for construction)
- Community Indoor Recreation Center (\$1.5 million for site acquisition)
- Library (\$1.2 million for site acquisition)
- Aquatics Center (\$2.1 million for site acquisition)
- Police Facility (\$1 million for site acquisition)
- Regional Soccer Complex (\$1 million for construction)
- Sewer Plant Improvement Project (\$1.8 million for construction)
- Butterfield Retention Basin (\$1.9 million for site acquisition)
- Butterfield Blvd. Construction-San Pedro to Tennant (\$3.3 million- site acquisition)
- Pavement Rehabilitation Program (\$2.2 million for construction)
- New Water reservoirs (\$4.5 million)
- Aggressive Affordable Housing Program (\$8 million)

Many of these projects are possible because of the referendum for the Plan Amendment to the 1981 Ojo de Agua Redevelopment Plan that was approved by the voters in November 1999. Of the total \$44.6 million in capital projects described in the CIP for 2001/02, \$25 million will be financed by the Redevelopment Agency.

APPROPRIATION LIMIT

The City's appropriations limit for this budget cycle has been prepared in accordance with the uniform guidelines. The appropriations limit imposed by Propositions 4 and 111 creates a restriction on the amount of "proceeds of taxes" which can be appropriated by the City in any fiscal year. The limit is based on actual appropriations during the 1978-79 fiscal year, and it is increased each year using the growth of population and inflation. The limit of \$49,900,365 for 2001/02 is significantly greater than the actual appropriations of \$12,471,489 subject to the limit for this year. Therefore, it appears that the City will not exceed its appropriations limit in the foreseeable future.

SUMMARY

The City and Redevelopment Agency are in a very positive financial position, where the resources are on hand or will be available to accomplish the major Visioning projects that the community desires, and where the City has the opportunity to prudently expand services to meet the demands of a growing community, yet still maintain appropriate financial reserves. This is the result of a strong economy over the past few years and the foresight of the City Council and community.

I want to acknowledge my appreciation to the members of the City Council for their continued support of programs that deliver necessary public services and for their sound fiscal policy. I also wish to express my appreciation to the talented and dedicated City staff for their assistance in the development of this budget.

Respectfully submitted,

J. Edward Tewes
City Manager